SUPREME COURT, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 1472

FIDUCIARY COUNSEL, INC.,

Petitioner,

v.

GEORGE P. SHULTZ, Sectetary of Labor,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

Carl L. Shipley
1108 National Press Building
Washington, D.C. 20004
Attorney for Fiduciary Counsel, Inc.

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Petitioner, Fiduciary Counsel, Inc., respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the District of Columbia entered in this proceeding December 14, 1970.

OPINIONS BELOW

The first opinion of the District Court was not reported. The initial decision of the Court of Appeals is found at 383 F.2d 203, sub nomine: *Fiduciary Counsel v. W. Willard Wirtz.* Petition for writ of certiorari was denied at 389 U.S. 1005. Neither the District Court nor the Court of Appeals second decisions have been reported. All judgments and opinions are contained in the Appendix, plus the relevant opinion of the Department of Labor.

JURISDICTION

This petition for certiorari is filed within 90 days of the judgment of the Court of Appeals which was entered on December 14, 1970. The Court has Jurisdiction under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether determination that petitioner is an "administrator" who "handles funds or property" under the Welfare and Pension Plans Disclosure Act was arbitrary and capricious and involved an administrative exercise of legislative power forbidden by Article I of the Federal Constitution.

2. Whether denial of petitioner's claim for exemption from the bonding requirements of the Welfare and Pension Plans Disclosure Act was unequal treatment violating the Fifth Amendment of the Federal Constitution.

CONSTITUTIONAL PROVISIONS INVOLVED

Article I, Section 1:

> "All legislative powers herein granted shall be vested in a Congress . . . ."

Amendment 5

> ". . . No person shall be deprived of property without due process of law; . . . ."

STATUTES INVOLVED

29 USC 304(b)

> "The term 'administrator' whenever used in this chapter, refers to . . . the person or persons . . . actually responsible for the control, disposition or management of the money received or contributed . . ."

29 USC 308(d)

> "Every administrator, officer, and employee of any employee welfare benefit plan or of any employee pension benefit plan . . . who handles funds or other property of such plan shall be bonded as herein provided . . . . The amount of such bond . . . shall be not less than 10 per centum of the amount of the funds handled . . . except that any such bond shall be in at least the amount of $1,000 and no such bond shall be required in an amount in excess of $500,000."

STATEMENT OF THE CASE

Petitioner, Fiduciary Counsel, Inc., is a registered investment adviser under the Investment Advisers Act of 1940, 15 U.S.C. § 80(b), *et seq.*, which has applied to the Secretary of Labor for exemption from the bonding requirements of the Welfare and Pension Plans Disclosure Act ("WPPDA"), 29 U.S.C. 301 *et seq.*

Since October 1, 1962, petitioner has been retained on a fee basis to act as investment counselor for two pension trusts of the Parker Pen Company, Janesville, Wisconsin. These trusts were established for the purpose of funding retirement, death and disability benefits for certain of Parker's employees. The trustee of each trust is the Merchants and Savings Bank of Janesville, Wisconsin. Each trust is noncontributory in that employees make no contributions to the trust fund. Parker Pen is the sole contributor. All funds of the two trusts are maintained in the custody of the trustee bank.

Under the trust instruments, the Merchants and Savings Bank of Janesville, Wisconsin, as corporate trustee, is given full power "to make such sales and investments from time to time in the trust fund held by it and to take every action with respect to the investment held therein as in its discretion it deems proper".

In addition, the trust instruments provide that the Parker Pen Company

> ". . .shall nevertheless have full power in its discretion from time to time to select and appoint an investment counsellor to direct the trustee to make sales and investments and retain investments with respect to the trust fund held by the corporate trustee, and the corporate trustee shall act on such directions of the investment counsellor and make every sale or investment or retention of investment with respect to the trust fund held by the corporate trustee, and the corporate trustee shall act on such directions of the investment counsellor and make every sale or investment or retention of investment with respect to the trust fund held by it is directed by the investment counsellor."

Further, the trust instruments provide that the Parker Pen Company "may remove the trustee at any time upon thirty days prior written notice to the trustee", and that either plan shall be terminated on thirty days' written notice from the Parker Pen Company.

Petitioner at no time has physical possession of any of the funds or property of the two Parker Pen trusts. Such funds and property are at all times in the custody of the Merchants and Savings Bank of Janesville, Wisconsin, the corporate trustee. From time to time since October 2, 1962, petitioner has directed the trustee bank, pursuant to the provisions of the trust instruments, to make sales and investments, and the trustee bank has complied with such investment advice. Such compliance is subject to the bank's discretion as outlined above.

Petitioner presently had bonding coverage for dishonesty losses which bond did not purport to comply with the WPPDA minimum.

Banks also serve as investment advisers. They have actual custody and possession of the assets of the welfare and pension plans which they advise. Federally-regulated banks serving as advisers and trustees to welfare and pension plans have been exempted from the Act's bonding requirements. Said exemption is based upon regulation by the F.D.I.C. which the Secretary of Labor has found assures bonding adequate to protect the beneficiaries. F.D.I.C. bond requirements, which employ the American Bankers' Association standard as a guide, are substantially less than the Act's 10% standard. The reduced bonds which are frequently less than 50% of the Act's standard, are deemed adequate on the ground that there is a greatly reduced danger of loss because of F.D.I.C. regulation. The F.D.I.C. continuing regulation consists of one surprise inspection per year and a requirement that four reports per year be submitted.

Upon denial of its request for exemption, petitioner brought suit for declaratory judgment in the U.S. District Court for the District of Columbia that it was not subject to the bonding provisions of the Act, and even if it were, denial of an exemption was arbitrary and capricious. On November 3, 1966, the court granted the Secretary's motion for summary judgment on stipulated facts. Appeal was taken to the U.S. Court of Appeals for the District of Columbia. By decision of July 7, 1967 that court held that petitioner was covered by the Act, but that a serious question of whether petitioner had been denied equal treatment remained. Petitioner filed in this Court for a writ of certiorari which was denied. *Fiduciary Counsel v. Wirtz*, 389 U.S. 1005. Thereupon, the case was remanded to the District Court which stayed execution pending further rule-making activities. On March 13, 1969, the Labor Department published a final rule which withdrew the bonding exemption of non-federally-regulated state banks and denied an exemption to invest-

ment advisers. Petitioner's renewed request for exemption was denied on March 10, 1969. The case was reinstated in the District Court which granted the Secretary's motion for summary judgment. The Court of Appeals affirmed on December 14, 1970.

REASONS FOR GRANTING THE WRIT

I

THE COURT BELOW ERRONEOUSLY INTERPRETED IMPORTANT PROVISIONS OF THE ACT WHICH HAVE A SUBSTANTIAL NATIONAL ECONOMIC EFFECT AND WHICH INVOLVE THE UNCONSTITUTIONAL EXERCISE OF LEGISLATIVE POWER BY AN ADMINISTRATIVE AGENCY.

In terms, the Act requires the bonding of "every administrator, officer and employee . . ." of certain welfare and pension plans. 29 U.S.C. 308d(a).

> "The term 'administrator' whenever used in this chapter, refers to–(1) *the* person . . . designated by the terms of the plan . . . with responsibility for the *ultimate* control, disposition, or management of the money received or contributed; . . . irrespective of whether such control, disposition or management is exercised directly or through an agent or trustee designated by such person . . ." 29 U.S.C.A., Section 304(b) (Emphasis added)

Under the terms of the trust instruments involved herein, the trustee (a national bank) makes sales and investments in its discretion; and if there is an investment counselor, also as the latter directs. But the Parker Pen Company has complete control and discretion in selecting and retaining parties to be the trustee and/or investment counselor. Petitioner as investment counselor is merely the "agent" of the Company and clearly does not have "ultimate responsibility" for the "control, disposition or management" of the corpus of the trust. Therefore, it cannot be an "administrator" within the meaning of the Act.

The District Court's ruling that petitioner was included within the Act because it is "one of the administrators of the fund" directly contradicts the clear wording of the statute that there can be but one administrator, to wit: "*the* person . . . with responsibility for *ultimate* control . . ."

Bonding is required only of one who "handles funds or other property" of a plan. 29 U.S.C. 306(a). The boundaries of the term "handle" are delineated in Section 13(b) of the Act which makes it unlawful without the requisite bond to,

> "receive, handle, disburse, or otherwise exercise custody or control of any of the funds or other property . . ."

Therefore, to "handle" it is necessary to have (1) physical custody or (2) the power to determine retention and the course of transfer. Since petitioner never has physical custody of funds or property. the only question is whether it "controls" the property of the plans. Since the investment counseling firm can be removed at any time by the Company, it can in substance only direct the trustee bank to buy and sell with the concurrence of the Company. Furthermore, the trustee may at any time act on its own discretion to buy and sell. Therefore, any directive from petitioner can be negated by the independent action of the trustee bank. Thus, Fiduciary Counsel can do only that which meets the approval of the Company and the trustee. To hold, that this is "control" within the meaning of the Act is to disregard the statute and extend its scope–a legislative activity which is beyond the power of the Secretary under the Federal Constitution.

Since the District Court based its conclusion that petitioner "handled" plan funds on the erroneous predication that Fiduciary Counsel can give "binding instructions", clear error was committed. That which can be undone is not binding.

Implementing regulations provide an exemption for those who would otherwise need bonding when "Their duties with

respect to investment policy are essentially advisory". 29 C.F.R. Section 464.7(b)(6)(ii)(b). Neither the District Court nor the Court of Appeals treated petitioner's assertion that since its entire purpose is to give advice, this exemption should apply.

By his regulations, the Secretary of Labor has modified and extended the Act with a dragnet web to include almost anyone having the remotest connection with a welfare and pension plan, regardless of whether or not they are, in fact or law, an administrator or handle plan funds or property.

> "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute is mere nullity." *Manhattan General Equipment Co. v. Commissioner Revenue*, 279 U.S. 129, 134 (1936); quoted with approval in *Dixon v. U.S.*, 381 U.S. 68, 74 (1965).

Congress defined its terms in the body of the Act; to deviate therefrom is to remake the law. No such power has been granted.

II

THE DECISION BELOW RAISES AN IMPORTANT QUESTION OF WIDESPREAD IMPACT INVOLVING THE FUNDAMENTAL RIGHT TO EQUAL TREATMENT UNDER GOVERNMENT REGULATION.

By regulation, the Secretary has granted exemption from the specified level of bonding to federally-regulated banks on the ground that a greatly reduced bond is adequate since the danger of loss to beneficiaries is not great, because of said federal regulation. Petitioner submitted that as an investment counselor, with no physical control of funds,

and subject to SEC regulation, short-notice removal, and neutralization by a trustee, it presented a negligible threat of loss. Thus, it contends that its bond which did not meet the statutory minimum was at least as adequate under the totality of circumstances as the banks' reduced bonds.

This contention that petitioner was being denied equal treatment was recognized by the Court of Appeals in its first decision.

> "It is just possible, therefore, that the employees of Parker Pen Company are in no greater danger of having their pension assets diminished by reason of the dishonest investment advice emanating from appellant than they would be if this advice were supplied by a state bank which is either not bonded at all or in an amount less than that required by the Act, or which is not examined at all or only in a perfunctory manner." App. 21a.

While the language is couched in terms of state banks, the principle is necessarily applicable to any exempted bank. Yet, the Secretary, during hearings after remand to the District Court, refused to consider the issue.

During those hearings, the matter was pointedly raised.

> "There is no method by which we could submit our Firms' bonds to the Labor Department for blanket bond approval in terms of establishing there is a financial responsibility on our part." Hearing Record, p. 44.

The Department of Labor's response leaves no doubt that it refused to consider the matter.

> ". . . [T]his hearing is confined to the question of whether, by virtue of the supervision exercised by the SEC, they [investment counsel] don't need to comply with the Act's bonding requirements." *Id.*

Not only the Secretary, but also the District Court and the Court of Appeals, failed to analyze whether the danger of loss presented by the arrangement under which petitioner functions is sufficiently reduced to render its bond adequate protection against such loss.

Note must be made of the magnitude of the advantage conferred upon banks by their exemption. The F.D.I.C. uses the American Bankers' Association standards as its basic guide. Thus, while fund assets require a bond of $500,000 under the Act's 10% rule, a bond of $150,000 would be *prima facie* sufficient for an exempted bank. App. 23a. Using an asset figure of $1,500,000, the Act requires a $150,000 bond while one of $75,000 likely suffices for an exempted bank.

Petitioner suffer loss of business through a disadvantaged competitive position and bears the burden of carrying substantially increased bonding because of patently unequal treatment in violation of its rights under the Fifth Amendment. See, *Bolling v. Sharpe*, 347 U.S. 497 (1954).

CONCLUSION

For the reasons set out hereinabove and because the statute involved has not heretofore been construed by this Court, or any other court except in this case, and additionally because serious constitutional questions are raised with respect to the right to equal treatment under government regulation and the extent to which the Secretary of Labor can administratively extend and broaden the reach of an act of Congress, petitioner requests that a writ of certiorari be granted.

Respectfully submitted,

Carl L. Shipley
1108 National Press Building
Washington, D.C. 20004
Attorney for Fiduciary Counsel, Inc.

March, 1971

APPENDIX A

UNITED STATES COURT OF APPEALS [no opinion]
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 23,987 September Term, 1970.

Civil Action No. 2665-63

Fiduciary Counsel, Inc.,

Appellant

v.

James D. Hodgson,
Secretary of Labor,
U.S. Department of Labor

Appeal from the United States District Court
for the District of Columbia

Before: Tamm and Robb, Circuit Judges, and Gordon,*
U.S. District Judge for the Eastern District of Wisconsin.

JUDGMENT

This cause came on to be heard on the record on appeal from the United States District Court for the District of Columbia, and was argued by counsel. While the issues presented occasion no need for an opinion, they have been accorded full consideration by the Court. *See* Local Rule 13(c).

On consideration of the foregoing, It is ordered and adjudged by this Court that the judgment of the District Court appealed from in this cause is hereby affirmed.

Per Curiam

For the Court:

Nathan J. Paulson
Clerk

December 14, 1970

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*Sitting by designation pursuant to 28 U.S.C. § 292(c).

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

[Caption omitted in printing]

ORDER

This cause having come on for hearing upon defendant's motion for summary judgment and on plaintiff's cross motion for summary judgment, and the Court having considered the motions of the parties, the points and authorities in support thereof and in opposition thereto, and the record of the administrative hearing incorporated therein, and having heard oral argument, and it appearing that there is no genuine issue as to any material fact and that the defendant is entitled to summary judgment as a matter of law, it is by the Court this 19th day of January 1970

ORDERED that plaintiff's cross motion for summary judgment be, and the same is, hereby denied.

ORDERED that defendant's motion for summary judgment be, and the same is, hereby granted.

ORDERED that judgment is entered in favor of defendant against plaintiff, and the action be, and the same is, hereby dismissed.

/s/ John J. Sirica
United States District Judge

APPENDIX C

March 10, 1969

Mr. Carl. L. Shipley
Shipley, Akerman & Pickett
1204 National Press Building
Washington, D.C. 20004

SOL: 64-(WP)-12

Re: *Bonding Exemption for Fiduciary Counsel, Inc. Under the Welfare and Pension Plans Disclosure Act*

Dear Mr. Shipley:

On August 15, 1967, you formally requested on behalf of your client, Fiduciary Counsel, Inc., New York, New York, that this Office reconsider its decision denying an exemption from the Welfare and Pension Plans Disclosure Act bonding requirement to Fiduciary Counsel, Inc. You were advised by the Secretary of Labor in a letter dated September 21, 1967 that the matter was being reviewed in light of the decision of the United States Court of Appeals for the District of Columbia in *Fiduciary Counsel, Inc. v. Wirtz.*

Subsequently, it was decided, with your concurrence, to hold the litigation in abeyance while administrative proceedings were conducted for the purpose of reexamining the regulations pertaining to class binding exemptions. As you know, formal Rule-Making hearings were held, written and oral comments were received, and proposed changes to the regulations were published in the Federal Register on January 23, 1969 (34 FR 1051). Among other things, the effect of the notice was to deny a class bonding exemption to investment advisers. Objections to the proposed changes presented no facts or argument not previously considered and the proposed changes will be shortly finalized by publication in the Federal Register.

In light of the foregoing, we are taking this opportunity to inform you that we reaffirm our prior determination

concerning the petition for exemption from Fiduciary Counsel, Inc. and hereby deny the petition for exemption.

Sincerely yours,

/s/ Frank H. Kleiler
Director

SOL: S.J. Sacher:
kre:3/6/69
ANB 807, Ext. 4073

DEPARTMENT OF LABOR

Assistant Secretary for Labor-Management Relations

IN THE MATTER OF BONDING EXEMPTIONS FOR FEDERALLY AND STATE-REGULATED BANKS AND INVESTMENT ADVISERS REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION

Section 13(e) of the Welfare and Pension Plans Disclosure Act, hereinafter referred to as WPPDA, 29 U.S.C. 308(e), authorizes the Secretary of Labor to exempt from the bonding requirement of section 13(a), WPPDA, 29 U.S.C. 308(a), when, in his opinion, it is demonstrated that "financial responsibility" or "other bonding arrangements" would adequately protect the beneficiaries and participants of welfare or pension plans subject to the Act.

On June 26, 1968 and June 29, 1968, notice was published in the Federal Register (33 F.R. 9346, 9556) inviting submission of written and oral communication of data, views or argument on the following issues:

1. Whether banks and trust companies subject to Federal regulation should as a class retain their present exemption from the WPPDA bonding requirement in light of the criteria set forth in section 13(e), WPPDA, 29 U.S.C. 308d(e)?

2. Whether banks and trust companies subject to state regulation should as a class retain their present

exemption from the WPPDA bonding requirement in light of the criteria in section 13(e), WPPDA, 29 U.S.C. 308d(e)?

3. Whether investment advisers registered with and regulated by the Securities and Exchange Commission pursuant to the Investment Advisers Act of 1940, 15 U.S.C. 80b and subject to 29 CFR Part 464 should as a class be granted an exemption from the WPPDA bonding requirement in light of the criteria in section 13(e), WPPDA, 29 U.S.C. 308d(e)?

Details relevant to the background of this rule-making proceeding are found in the Federal Register Notice of June 26, 1968 (33 F.R. 9346) and in *Fiduciary Counsel, Inc. v. Wirtz*, 383 F.2d 203 (C.A.D.C. 1967). Pursuant to the same notice, hearings on this subject were held on August 12, 1968 and September 20, 1968 before John Mealy, a Hearing Examiner appointed pursuant to 5 U.S.C. 3105 (Supp. II, 1965-66), and the complete record of these proceedings was certified to me on October 15, 1968 for a determination of such amendments to the WPPDA bonding regulations relative to exemptions as are appropriate.

On the basis of the complete record of these proceedings, I have made the following material findings of fact and conclusions.

FINDINGS OF FACT

BANKS AND TRUST COMPANIES SUBJECT TO FEDERAL REGULATION

1. Banks[1] which are subject to federal regulation are: (1) national banks which are chartered, regulated and examined by the Comptroller of the Currency, which must, by statute, be members of the Federal Reserve System, and which are automatically insured by the Federal Deposit Insurance Corporation (F.D.I.C.), (2) State chartered banks

[1] Unless otherwise indicated herein, the word "bank" denotes a commercial bank or trust company.

which apply for and meet the requirements for membership in the Federal Reserve System and which are automatically insured by the F.D.I.C., and, (3) State chartered banks, not members of the Federal Reserve System, which apply to and are accepted by the F.D.I.C. for insurance.[2]

2. All federally regulated banks are required by the F.D.I.C. to purchase fidelity bonding. If a bank refuses to purchase the required bond, the F.D.I.C. is authorized to purchase the bond for it and to add the premium cost thereof to the assessment otherwise payable by the bank for deposit insurance.[3]

3. Bond size in each case is based upon a schedule recommended by the American Bankers Association, modified by the F.D.I.C. according to the particular condition of the bank.[4]

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[2]Thus the term "federally regulated," as regards banks, means that one or more of the three federal banking agencies exercises supervision over the bank. At the very least, it means that the bank is insured by the F.D.I.C. and is subject to its regulation. See Exhibit No. 5, letter from William B. Camp, Comptroller of the Currency, Department of the Treasury, page 2; Exhibit No. 6, letter from K.A. Randall, Chairman, Federal Deposit Insurance Corporation, August 7, 1968, page 2; and Exhibit No. 4, Department of Labor submission, pages 6, 18, 27 and 28. Statutory authority for the regulatory functions exercised by the Comptroller for the regulatory functions exercised by the Comptroller of the Currency is found at 12 U.S.C. 21 *et seq.*; that of the Board of Governors of the Federal Reserve System is at 12 U.S.C. 221 *et seq.*; and Federal Deposit Insurance Corporation functions are found at 12 U.S.C. 1811 *et seq*. Federally regulated banks include all but 224 of the nation's 13,741 banks. Exhibit No. 6, page 3.

[3]The F.D.I.C. reports that it has had no difficulty persuading banks to purchase bonds and has never had to purchase a bond for a bank. Exhibit No. 6, pages 3-4.

[4]"Examiners are given specific instructions with respect to fidelity protection and internal routine and controls. Engagement in trust activities is among the factors which may dictate a need for insurance in amounts higher than those suggested by the American Bankers Association . . . . During the past ten years, special emphasis has been placed by the bank supervisory authorities upon the purchase by

4. In addition to requiring the purchase of bonds, the F.D.I.C. periodically checks the condition of each bank for the purpose, among other things, of making certain that bonding protection remains at the proper level.[5] All state chartered banks which are not federal reserve members are examined at least once a year by F.D.I.C. examiners.[6] In the case of national banks and state member banks of the Federal Reserve System, examinations are conducted by the Comptroller of the Currency and the Federal Reserve Banks respectively and the results forwarded to the F.D.I.C.[7] In addition, reports of condition must be submitted by each federally regulated bank. State chartered non-member banks must submit four reports per year to the F.D.I.C.,[8] which also receives copies of similar reports received by the Comptroller and the Federal Reserve System from banks under their supervision.[9]

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banks of excess employee dishonesty coverage, and a majority of the insured commercial banks have now purchased this extra fidelity protection." Exhibit No. 6, page 4. The American Bankers Association recommendations for bonding levels is reproduced in Exhibit No. 28E, American Bankers Association submission, and in Exhibit No. 4, page 38.

[5]Exhibit No. 4, page 37.

[6]Exhibit No. 6, page 3.

[7]The Comptroller's Office examines National Banks at least three times every two years, and all trust departments are examined annually on a surprise basis. Exhibit No. 5, page 3. State member banks are examined once a year by the Federal Reserve Bank of their district, with separate examination of trust departments by specially trained personnel. Exhibit No. 4, page 25; Exhibit No. 28D-3, 1967 Annual Report of the Board of Governors of the Federal Reserve System, page 318, American Bankers Association submission.

[8]Exhibit No. 4, page 35.

[9]State member banks must file at least three reports per year with the Federal Reserve bank in their district. Exhibit No. 4, page 23. National banks submit at least three reports per year to the Comptroller. Exhibit No. 4, page 12.

BANKS AND TRUST COMPANIES SUBJECT ONLY TO STATE REGULATION

1. Six states do not require bonding of bank officers and employees.[10] Of the remaining states, only 24 require approval of bond levels and forms.[11]

2. State minimum capital and reserve requirements vary widely; there is no uniformity. One state has no statutory minimum capital requirements.[12] Another has no statutory minimum reserve requirements.[13]

3. All states have statutory examination requirements, but the frequency of examinations varies. Two-thirds of the states require examinations annually; twelve states require two per year; one state requires two every eighteen months and in two states the number is left to the discretion of the banking supervisor.[14] Over ½ of the state supervisors reported that their staffs were inadequate for examining purposes.[15] Only 31 states have statutory requirements for an annual internal audit by or for the bank boards of directors.[16]

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[10]California, Delaware, Illinois, Massachusetts, Oregon and Rhode Island. The word "states" includes the Commonwealth of Puerto Rico but not the District of Columbia, the banks of which are federally regulated. Exhibit No. 4, page 48; Exhibit No. 28H-6, American Bankers Association compilation of relevant state statutes.

[11]Exhibit No. 4, page 47.

[12]Exhibit No. 4A-10, pages 43-44. Ninth Quinquennial Survey, State Bank Division, American Bankers Association, Department of Labor submission. The state is Rhode Island.

[13]Id., page 53. The state is Illinois.

[14]Id., page 38.

[15]Id., pages 29, 29A and 30. Over 1/3 of the Supervisers indicated that the funds available to their departments were not adequate. Id., page 7A.

[16]Id., pages 54-55.

INVESTMENT ADVISERS REGULATED BY THE SECURITIES AND EXCHANGE COMMISSION

1. The Securities and Exchange Commission (S.E.C.) exercises regulatory functions over investment advisers pursuant to the Investment Advisers Act of 1940.[17]

2. The S.E.C. does not require bonding of investment advisers; no other federal government agency requires bonding. Nor does the S.E.C. or any other federal government agency supervise bond size and form in those cases where a bond has been procured by an investment adviser on its own initiative.[18]

3. The S.E.C. has no minimum capital requirements, nor does it require that any minimum reserve be maintained. It does impose registration and record keeping requirements.[19]

4. Other aspects of S.E.C. regulation which are pertinent to financial responsibility are periodic surprise inspections by the S.E.C.[20] and the requirement of a surprise annual audit by an independent public accountant where the investment adviser has custody of funds or securities.[21] However,

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[17] 15 U.S.C. 80b-1 *et seq*.

[18] Exhibit No. 4, pages 62-63. The scope of regulatory functions performed by the S.E.C. is fully set out at pages 51-59. See also Exhibit No. 7, letter from Ezra Weiss, Associate Chief Counsel, S.E.C., page 1.

[19] 15 U.S.C. 80b-3, 17 CFR 275.205-2(a)-(c). But these requirements are only secondarily pertinent to financial responsibility. Their primary purpose is the prevention of securities frauds. An Associate Chief Counsel of the S.E.C. states: . . . unlike the Securities and and Exchange Act of 1934, . . . the Investment Advisers Act does not contain specific authorization for the Commission to provide safeguards for clients by prescribing specific financial responsibility requirements for investment advisers. Consequently, no financial responsibility requirements are imposed upon investment advisers as a condition of registration or the operation of their business." Exhibit No. 7, page 1.

[20] 15 U.S.C. 80b-4.

[21] 17 CFR 275.206(4)-2(a).

the surprise inspections by the S.E.C. are infrequent, never as often as once a year and sometimes as seldom as once every three years or more,[22] and since very few investment advisers have custody of funds or securities, the overwhelming majority are not subject to a surprise examination by a public accountant.[23]

CONCLUSIONS

1. Banks and trust companies subject to Federal regulation should as a class retain their present exemption from the WPPDA bonding requirement since all such institutions are required to maintain bonds the adequacy of which is closely supervised by Federal regulatory authority. By virtue of this supervision, it is concluded that such bonds are "other bonding arrangements" within the contemplation of section 13(e), WPPDA, which provide adequate protection of the beneficiaries and participants of employee benefit plans serviced by these institutions.

2. Banks and trust companies subject to only state regulation should not as a class retain their present exemption from the WPPDA bonding requirement since not all states require bonding or closely supervise the adequacy of bonding arrangements entered into, because the financial responsibility requirements of states vary too widely to permit a judgment as to their adequacy on a class basis, and because the effectiveness of some state banking supervision is in doubt by reason of a reported inadequacy in staffs. It is concluded that state regulated banks as a class do not, within the contemplation of section 13(e), WPPDA, offer adequate evidence of "financial responsibility" of the plans they service and do not have "other bonding arrangements" which provide adequate protection for the beneficiaries and parti-

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[22] Exhibit No. 4, page 59, Transcript of Hearing, page 121.

[23] Exhibit No. 7, page 2, Transcript, pages 37, 39, 42, 67, 80, 83 and 129.

cipants of the plans they service. This conclusion shall not prejudice the right of any state-regulated bank or trust company to petition for a bonding exemption on an individual basis.

3. Investment advisers registered with and regulated by the Securities and Exchange Commission pursuant to the Investment Advisers Act of 1940 and subject to 29 CFR 464 should not as a class be granted an exemption from the WPPDA bonding requirement since the Securities and Exchange Commission does not impose or supervise a bonding requirement with respect to investment advisers, because the Securities and Exchange Commission does not impose or supervise any requirement with respect to investment advisers, pertaining to the maintenance of a sound financial condition, and because the periodic inspections conducted by the Securities and Exchange Commission are not conducted frequently enough to satisfactorily insure the implementation of the fiscal safeguards imposed on investment advisers by law. It is concluded that investment advisers registered with and regulated by the Securities and Exchange Commission as a class do not, within the contemplation of section 13(e), WPPDA, offer adequate evidence of "financial responsibility" of the plans they service and do not have "other bonding arrangements" which provide adequate protection for the beneficiaries and participants of the plans they service. This conclusion shall not prejudice the right of any investment adviser to petition for a bonding exemption on an individual basis.

In view of the foregoing findings of fact and conclusions, I have determined that (1) the existing class exemption from the WPPDA bonding requirement for those banks and trust companies which are federally regulated shall be continued, (2) the existing class exemption from the WPPDA bonding requirement for those banks and trust companies which are subject only to state regulation shall be revoked, and (3) investment advisers registered with and regulated by the Securities and Exchange Commission shall not be granted an exemption from the WPPDA bonding requirement.

This decision shall be implemented by publication of a notice in the Federal Register proposing appropriate amendments to the WPPDA bonding regulations, 29 CFR 464, 465.

Signed at Washington, D.C. this 11th day of January, 1969.

THOMAS R. DONAHUE
Assistant Secretary of Labor

ORAL OPINION OF THE DISTRICT COURT

October 20, 1966

OPINION OF THE COURT

THE COURT: This is an action for a declaratory judgment and is before the Court on cross motions for summary judgment.

This action is brought by an investment counsel against the Secretary of Labor to determine whether the plaintiff is obligated to give a bond in connection with its participation in the management of an employees' welfare fund established by a concern known as the Parker Pen Company.

The question before the Court involves a construction of Section 308-d, Subsection (a), 29 United States Code. Sections 1 and the following of that Title contain regulations and provisions in respect to employee welfare and pension benefit plans created by employers engaged in interstate commerce or whose business affects interstate commerce. Section 308-d, which relates to bonds, provides, in Paragraph (a), that:

> "Every administrator, officer and employee of any employee welfare benefit plan or of any employees' pension benefit plan subject to this Chapter who handles funds or other property of such plan, shall [3] be bonded as herein provided."

This fund, as stated before, was created by the Parker Pen Company for the benefit of its employees. It consists

entirely of contributions made by the Parker Pen Company. The trustee of the fund is a bank located in Wisconsin.

The stipulated facts indicate that while the corporate trustee was given full power to make sales and investments from time to time in the trust fund held by it, the Parker Pen Company nevertheless retained the power to select and appoint an investment counsellor to direct the trustee to make sales and investments and retain investments. It is further provided that the corporate trustee shall act on such direction of the investment counsellor and make every sale or investment or retention of investments with respect to the trust fund held by it as directed by the investment counsellor.

The plaintiff, a corporation engaged in investment counselling business, was designated by the Parker Pen Company as the investment counsellor under this provision of the trust instrument.

The Secretary of Labor has expressed the view that the requirement for giving a bond applies to the plaintiff, Fiduciary Counsel, Inc., who has been named as the investment counsellor. Plaintiff disputes the views of the Secretary of Labor.

[4] Concededly there is a justiciable controversy which is suitable for disposition by a declaratory judgment.

The bonding provisions of the statute to which reference has been made apply to every administrator, officer and employee of a plan.

It is argued in behalf of the plaintiff, first, that the investment counsellor in this instance is neither an administrator, officer or employee of the plan. The Court is of the opinion that this is too narrow a view. The investment counsellor in this instance participates in the administration of the fund because it not only advises but actually gives binding directions as to what investments should or should not be made. It is reasonable to construe the provision as applying to the plaintiff as one of the administrators of the fund.

There may be more than one administrator. The Court is of the opinion that the Secretary of Labor acted reasonably in construing the word "administrator" as applying to the plaintiff.

The next objection interposed is that the plaintiff is not a person who handles the funds, while the bonding provision is limited to those persons who handle the funds of the plan. The word "handles" should not be limited to writing [5] out and signing checks or making deposits. A person who has the power to give binding directions as to the investment of the fund participates in handling the funds. The situation would be different if the function of the plaintiff was limited to giving advice. In this instance it is not so restricted. The plaintiff is empowered to give binding directions as to what securities should be purchased and sold.

It is then argued that the plan does not come within the statute because another provision of 308-d excepts from the bonding requirements those plans under which the only assets from which benefits are paid are the general assets of a union or of an employer. The trust fund created by the Parker Pen Company cease to be general assets of the employer once they are turned over to the trustee. The mere fact that the Parker Pen Company has a right to change the trustee does not make the trust fund a part of its general assets.

Additional light is thrown upon the meaning of Section 308-d by Subsection (b) of that Section, which makes it a criminal offense for any administrator, officer or employee to whom Subsection (a) applies, to receive, handle, disburse or otherwise exercise custody or control of any of the funds of the plan without being bonded. Surely it cannot [6] be said that the investment counsellor is not exercising control when it is authorized to give binding directions as to what investments shall be purchased or sold.

In view of these considerations the Court is of the opinion that the bonding requirement is applicable to the plaintiff in this action.

The Court recognizes that the requirement of a bond of the size here involved will involve a considerable expense for a bond premium that would be some drain on the fund. This is not a consideration, however, that the Court has a right to consider. Perhaps it is better to expend additional money to give additional protection to the fund than to save that expense.

Accordingly, the Court will deny the plaintiff's motion for summary judgment and grant the defendant's motion for summary judgment.

You may submit an appropriate order.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 20,620

FIDUCIARY COUNSEL, INC., APPELLANT,

v.

W. WILLARD WIRTZ, Secretary of Labor, APPELLEE.

Appeal from the United States District Court
for the District of Columbia

Decided July 7, 1967

Mr. Carl L. Shipley for appellant.

Mr. Jack H. Weiner, Attorney, Department of Justice, with whom *Messrs. David G. Bress,* United States Attorney, and *Morton Hollander,* Attorney, Department of Justice, were on the brief, for appellee. *Messrs. Alan S. Rosenthal* and *Richard S. Salzman,* Attorneys, Department of Justice, also entered appearances for appellee.

Before BAZELON, *Chief Judge,* McGOWAN and LEVENTHAL, *Circuit Judges.*

McGOWAN, *Circuit Judge:* Appellant, a registered investment adviser under the Investment Advisers Act of 1940, 15 U.S.C. § 80b (1964), and subject to regulation thereunder by the Securities and Exchange Commission, sought declaratory relief in the District Court against appellee,

who is charged with the administration of the Welfare and Pension Plans Disclosure Act, 29 U.S.C. §§ 301 *et seq.* (1964). Appellant asserted that it was not, as claimed by appellee, subject to the Act under the circumstances shown by this record; and that, even if it were, exemption from the statute is being discriminatorily, and therefore arbitrarily, withheld from it. The facts were stipulated. On cross-motions for summary judgment, the District Court dealt in terms with appellant's arguments as to the inapplicability of the statute, and disallowed them. It did not address itself expressly to appellant's alternative contention. We have no reason to reject the District Court's conclusions as to the coverage of the statute. We think, however, that it failed to recognize the substantial issue raised by appellant's assertion that its treatment in the matter of exemption is insupportable.

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Appellant has, since 1962, acted as investment adviser in respect of two employee pension trusts of the Parker Pen Company, of Janesville, Wisconsin. The employer is the sole contributor; and a Janesville bank is the trustee. Although the trust instruments seemingly embody an unrestricted power in the trustee to control investment, they also clearly grant to the employer a right to retain an investment adviser who can give to the trustee binding directions as to investment. Appellant at no time has physical possession of any of the trust assets.

Appellee has notified appellant that it should comply with the bonding requirements of Section 308(d) of the Welfare and Pension Plans Disclosure Act. That section, the key provision of which is set forth in the margin,[1]

[1] "Every administrator, officer, and employee of any employee welfare benefit plan or of any employee pension benefit plan subject to this chapter who handles funds or

makes it unlawful "to receive, handle, disburse, or otherwise exercise custody or control" of any of the assets of a pension plan without being bonded in the required manner. Bearing in mind the Congressional concerns about the jeopardy in which pension assets had been placed by the dissipation which can flow from either direct thievery or dishonest investment, we think, as said above, that the District Court does not appear to have erred in its rejection of appellant's contentions that it is outside the statutory reach.[2] It is the issue raised by appellant but not discussed by the court, namely, the matter of exemption, which confronts us with difficulty.

Paragraph (e) of Section 308(d) provides as follows:

> Regulations; exemption of plan
>
> The Secretary shall from time to time issue such regulations as may be necessary to carry out the provisions of this section. When, in the opinion of the Secretary, the administrator of a plan offers adequate evidence of the financial responsibility of the plan, or that other bonding arrangements would provide adequate protection of the beneficiaries and participants, he may exempt such plan from the requirements of this section.

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other property of such plan shall be bonded as herein provided; except that, where such plan is one under which the only assets from which benefits are paid are the general assets of a union or of an employer, the administrator, officers and employees of such plan shall be exempt from the bonding requirements of this section." 29 U.S.C. § 308(d)(a) (1964).

[2] Appellant variously argued, by reference to the statute itself, that (1) it was not an administrator, officer, or employee of the plan within the meaning of the Act, (2) the Act was confined to those who physically "handle" fund assets, and (3) the plans here involved were outside the Act because the only assets involved were part of the general assets of the employer.

Under the authority of that grant of exempting power, appellee has promulgated this regulation (29 C.F.R. § 464.4(e):

> The terms "administrator, officer, and employee" shall not be deemed to include the following independent institutions, or natural persons acting in an employment or other representative capacity for such institutions, except with respect to covered plans for the benefit of their own employees:
>
> (1) any bank or trust company subject to regulation and examination by the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, or the Federal Deposit Insurance Corporation, or chartered under the laws of any State and operating in accordance with State law and subject to State supervision and examination.

The institutions so exempted are those with whom appellant competes for the business of providing investment advice. If they are to be relieved of the substantial cost of providing a bond under the Act while appellant is not, the latter's ability to compete is adversely affected. If, says appellant, exempting the one and not the other has no reasonable basis, then the denial of exemption to appellant offends both statute and constitution. It has no such basis, argues appellant, because the regulatory criteria employed in the regulation give no significantly greater assurance of security to the pension assets than do the regulatory conditions under which appellant has to function.

We note that Congress appeared to conceive that it was empowering the Secretary to give exemption to a particular plan, as distinct from interpreting the statute as not applying to certain persons. This is indicated both by the title of paragraph (e)—"Regulations; exemption of plan"—as well as by its provision that when "the administrator of a plan offers adequate evidence of the financial

responsibility of the plan, or that other bonding arrangements would provide adequate protection . . . [the Secretary] may exempt *such plan*. . . ." (Emphasis supplied.) Under the statute, a bank would not appear to be entitled to exemption until after it applies for it in respect of a particular plan and "offers adequate evidence" with respect to the statutory standards. The regulation, contrarily, defines a bank subject to state or federal supervision as not being an "administrator" within the meaning of the statutory command for bonding. The assurance of security for the particular plan in terms of "financial responsibility" or "other bonding arrangements" resides only in the fact that the bank is subject to federal or state supervision and examination.

The nature of that supervision varies widely. As appellant points out and appellee concedes, at least four states do not include bonding within their regulatory requirements; and Iowa, although it requires bonding, does not subject its banks to examination. Appellant points in this regard to the comprehensive character of the regulation which Congress has imposed upon it in the implementation of the "national concern" that the clients of investment advisers be assured of honest and responsible services from those engaged in that business. Investment advisers may not function without applying for authority by means of registration with the Securities and Exchange Commission. 15 U.S.C. § 80b-3(a)(1964). Such registration involves full information about the applicant and its methods of operation. 15 U.S.C. § 80b-3(c). The reporting and record-keeping requirements are extensive, 15 U.S.C. § 80b-4; 17 C.F.R. § 275.204-2; and the substantive prohibitions of fraudulent and faithless actions are as explicit as the penalties are severe. 15 U.S.C. § 80b-6 & 7; 15 U.S.C. § 80b-17. If an investment adviser actually acquires physical custody of a client's assets, the segregation and handling requirements are strict, and the adviser

is subject to a surprise annual audit. 17 C.F.R. § 275. 206(4)-2.

It is just possible, therefore, that the employees of Parker Pen Company are in no greater danger of having their pension assets diminished by reason of the dishonest investment advice emanating from appellant than they would be if this advice were supplied by a state bank which is either not bonded at all or in an amount less than that required by the Act, or which is not examined at all or only in a perfunctory manner.[3] In any event, appellee's exempting regulation is not constructed so as to give him an opportunity to compare these relative dangers. For all practical purposes, banks are declared outside the statute without reference to whether the character of the regulation applicable to a particular bank comports with either of the statutory standards by which Congress has said that the exemption of a particular plan is to be measured.

We do not say that the regulation is invalid as it stands. Neither we nor the District Court were asked to do this, and any such claim has not been raised and developed in a manner suitable for its wise resolution. We do say that the form in which the regulation is cast raises serious questions as to why one situated as was appellant was not also brought within its embrace. The District Court, as we have noted, did not comment in any way upon this aspect of appellant's case as alleged in its complaint. We reverse the grant of summary judgment to appellee, and

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[3] The stipulated facts recite that, except for four officers, appellant's employees are covered by a Blanket Honesty Bond issued by the Indemnity Insurance Company of North America. It is recited that this bond falls short of the bond requirements specified in the Act, but we note that appellee's exempting regulation comprehends banks with either no bonds at all or those which fall below the statutory prescription.

remand in order that the District Court may address itself to this issue on the basis of such evidence as may be relevant to the reasonableness of appellee's action in exempting the banks but not appellant.

It is so ordered.

MEMORANDUM DECISIONS

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389 U.S. 1005

FIDUCIARY COUNSEL, INC., petitioner, v. W. Willard WIRTZ, Secretary of Labor. No. 681.

Facts and opinion, 127 U.S.App.D.C. 276, 383 F.2d 203.

Carl L. Shipley, for petitioner.

Solicitor General Griswold, Assistant Attorney General Weisl, Morton Hollander, Jack H. Weiner, Charles Donahue and George T. Avery, for respondent.

Petition for writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit.

Dec. 11, 1967. Denied.

* * *

AMOUNTS OF BLANKET BOND COVERAGE

Banks with Deposits of	*Suggested Range of Amounts*
Less than $750,000	$25,000 to 50,000
$750,000 to 1,500,000	50,000 to 75,000
1,500,000 to 2,000,000	75,000 to 90,000
2,000,000 to 3,000,000	90,000 to 120,000
3,000,000 to 5,000,000	120,000 to 150,000
5,000,000 to 7,500,000	150,000 to 175,000
7,500,000 to 10,000,000	175,000 to 200,000
10,000,000 to 15,000,000	200,000 to 250,000
15,000,000 to 20,000,000	250,000 to 300,000
20,000,000 to 25,000,000	300,000 to 350,000
25,000,000 to 35,000,000	350,000 to 450,000
35,000,000 to 50,000,000	450,000 to 550,000
50,000,000 to 75,000,000	550,000 to 700,000
75,000,000 to 100,000,000	700,000 to 850,000
100,000,000 to 150,000,000	850,000 to 1,200,000
150,000,000 to 250,000,000	1,200,000 to 1,700,000
250,000,000 to 500,000,000	1,700,000 to 2,500,000
500,000,000 to 1,000,000,000	2,500,000, to 4,000,000
1,000,000,000 to 2,000,000,000	4,000,000 to 6,000,000
Over $2,000,000,000	6,000,000 and up